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TREASURY FOR REBECCA KLEIN
COMMERCE FOR BECKY ERKUL

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PTER, KCOR, KE
SUBJECT: Kenya: Macroeconomic Update

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1. (SBU) SUMMARY In a January 8 meeting with Econoffs, Dr. Geoffrey Mwau, Ministry of Finance Economic Secretary, spoke strongly in favor of Kenya applying for a new International Monetary Fund (IMF) program in the range of \$1 billion over three years. While Minister of Finance Kenyatta is not yet convinced that the GOK should make the request, Mwau believes they will do so by the time of the Bank/Fund spring meetings. Mwau stated that the forensic audit on the maize scandal is complete and should be released soon. Mwau expected that the waiver on duties for maize would be extended for another three to six months. He expressed pride in the MoF auditors who uncovered corruption in the Ministry of Education (MoE) Free Primary Education Program (FPE) and expected that donors would resume funding relatively quickly. Mwau related serious concerns from the MoF perspective regarding the new constitution, especially the lack of codified fiscal management and oversight. He speculated that without a strong fourth quarter, Kenya would likely see 2 percent GDP growth for 2009. ECON/C expressed concern about rumors that Charterhouse Bank (ref B) might be permitted to reopen. Mwau did not believe it was imminent but other more credible sources have indicated that it is. We are actively seeking to persuade the GOK not to go forward. End Summary

IMF Program

2. (SBU) Mwau strongly favors a new IMF program for Kenya. He believes that a nearly \$1 billion program over three years would be beneficial to Kenya. (Note: We heard from the IMF resrep here that the request would be \$600 million over three years. End Note) Kenya's need for infrastructure improvements, including water, road, rail, and energy, require substantial financing. Mwau cited energy sector needs alone of \$3 billion over the next three years to finance geothermal development and high voltage lines to interconnect energy grids with Ethiopia. He believes that Kenya must access as much concessional financing as possible. Currently, Kenya's debt load sits at 43% of GDP and the MoF would like to reduce that to 40%. Without concessional financing offered by the IMF, which he believes would trigger further concessional financing from the EU and potentially other bodies, Kenya's debt load will increase as efforts to sustain development continue.

13. (SBU) The potential IMF program has been held up at the ministerial level as a political issue. The Minister of Finance, Uhuru Kenyatta, does not favor the new IMF program over concerns whether Kenya could sustain the macro-economic conditionality of a program. Kenyatta may also be concerned about the USG possibly blocking the new IMF program. Both Mwau and the Permanent Secretary of Finance, Joseph Kinyua, believe that Kenya can maintain the macro-economic requirements. Kinyua is expected to again request support from Kenyatta for the new program. The possibility remains that requesting an IMF program could be approved by the Kenyan cabinet in time for the Bank/Fund spring meetings if the politicians can be convinced. The cabinet-level politicians, many of whom will be running for higher office, may also be concerned about the timing of a new IMF program prior to the elections scheduled for 2012.

14. (SBU) According to the IMF resrep, having heard several Executive Directors, including the USED , speak to corruption as a "macro-critical issue" at the December 22 Board meeting on Kenya's Article IV consultation the IMF would want to continue working governance issues through its public finance management assistance program. At the same time, under a potential IMF program with Kenya, he proposed to include a component that tracked Kenyan

NAIROBI 00000088 002 OF 003

spending on institutions/programs related to the reform agenda.

Maize

15. (SBU) The forensic audit looking into the maize scandal, which Prime Minister Raila Odinga promised months ago to release to the public, remains unavailable. According to Mwau, the report is done and he has heard of briefings on the final draft but has not seen the report itself. He expects the report to be released soon. At a recent World Bank coordination meeting, donors agreed to send a joint letter to the Prime Minister requesting the immediate release of the audit.

16. (SBU) Mwau expects that the maize duty waiver will be extended for at least three months and potentially for six months through June. According to Mwau, the maize duty waiver must be justified and processed through the East African Community (EAC) although our understanding is that the GOK has not sought EAC agreement to previous waivers. Mwau would like the waiver to extend through June and believes that the extension should have been signaled in November. His understanding is that the current request is only for three additional months. Kenyan media has reported a great deal of conflicting information on the maize duty waiver situation with the Minister of Agriculture, William Ruto, claiming that the extension is already done and the Kenya Revenue Authority stating that the extension isn't needed and should end. With the current waiver expiring in January, importers have halted fresh orders of maize which is raising concerns over price hikes and further food insecurity.

Free Primary Education Scandal

17. (SBU) Mwau expressed a great deal of pride about the MoF auditor's role in bringing to light the Free Primary Education Program scandal (ref A). He stated that the audit was purely a MoF initiative and demonstrated the strong internal audit capabilities of the MoF. (Note: According to the World Bank, the MoF commenced the audit at the Bank's request. End note.) Apparently, the MoF has built fraud "traps" into all of the World Bank funded projects and Mwau is confident in the MoF ability to stop corruption. He believes that the key to fighting corruption now involves focusing the judiciary in actually prosecuting and convicting those guilty of fraud. In opposition to what we have previously learned regarding the scandal, Mwau claimed that the audit had covered the full financial year and only uncovered the one month of fraud. The UK Department for International Development (DfID) previously informed us that the audit had only covered one month and further audits would be requested to cover the full year and the previous year; a view shared by the World Bank. Mwau also expected that donor funding would resume quickly and stated that donor funding had not actually been cut off, which also contradicts what we been told directly from DfID and the WB.

MoF Constitution Concerns

NAIROBI 00000088 003 OF 003

18. (SBU) Mwau expressed serious concerns regarding the draft constitution. His primary concern involves the lack of financial controls and oversight in the draft. The MoF does not retain its control over borrowing or accounting in the new constitution. He believes that only a strong MoF will be able to keep Parliament in check especially regarding sound macroeconomic stability, which heretofore has been one of Kenya's strengths.

GDP Growth

19. (SBU) GDP growth in Kenya stagnated in the third quarter of 2009 at zero percent growth due to drought, electricity shortages and reduced construction. Unless fourth quarter growth is impressive, Mwau believes 2009 GDP growth will be lucky to come in over two percent. If fourth quarter growth is strong, GDP growth could hit 2.5 percent; the IMF and WB share Mwau's forecast of 2-2.5% growth. For 2010, Mwau thought that growth would come in between three and four percent. He seems to be more optimistic and believes four percent is more likely and five percent remains in the realm of possibility, especially if the short rains continue through January. The rains help with agriculture, a key component of growth, as well as electricity generation. Mwau believes that manufacturing should pick up in 2010 and mining could also see a big year as industrial scale development of gold mining in Western Kenya begins. The World Bank recently told donors it expects 3.5% growth in 2010, assuming a steady global recovery and no new shocks to Kenya's economy. The IMF generally shares the Bank's forecast. Central Bank of Kenya (CBK) Governor Ndung'u told us 2010 has started well for Kenya's economy with good rains and anticipated benefits from further East African Community (EAC) integration. He is concerned about recent U.S. job numbers which sent a "shiver" through markets and lagging horticulture (cut flowers in particular) exports. The CBK chief is also worried about the effect of continued high energy prices on the country's ability to bounce back in 2010.

Charterhouse Bank

¶10. (SBU) EconCouns expressed Embassy concerns about the possible re-establishment of Charterhouse Bank (ref B), a criminal entity posing as a bank which was closed several years ago. Mwau did not have any direct knowledge of the possible re-opening. He didn't think that the re-establishment was close to becoming reality. He noted that PS Kinyua was concerned and had taken a strong position against it. He also related that with the passage and signing of the Anti-Money Laundering bill, Kenya had more tools to deal with the kinds of activities previously seen at Charterhouse Bank. All that said, other, more credible sources, including in the PM's office, continue to indicate that a reopening of this "bank" is imminent. On January 13, the CBK Governor told us that while permission to reopen the bank was not imminent, he strongly implied that it was just a matter of time. We are actively working to persuade the GOK at the highest level that this would be a mistake.

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